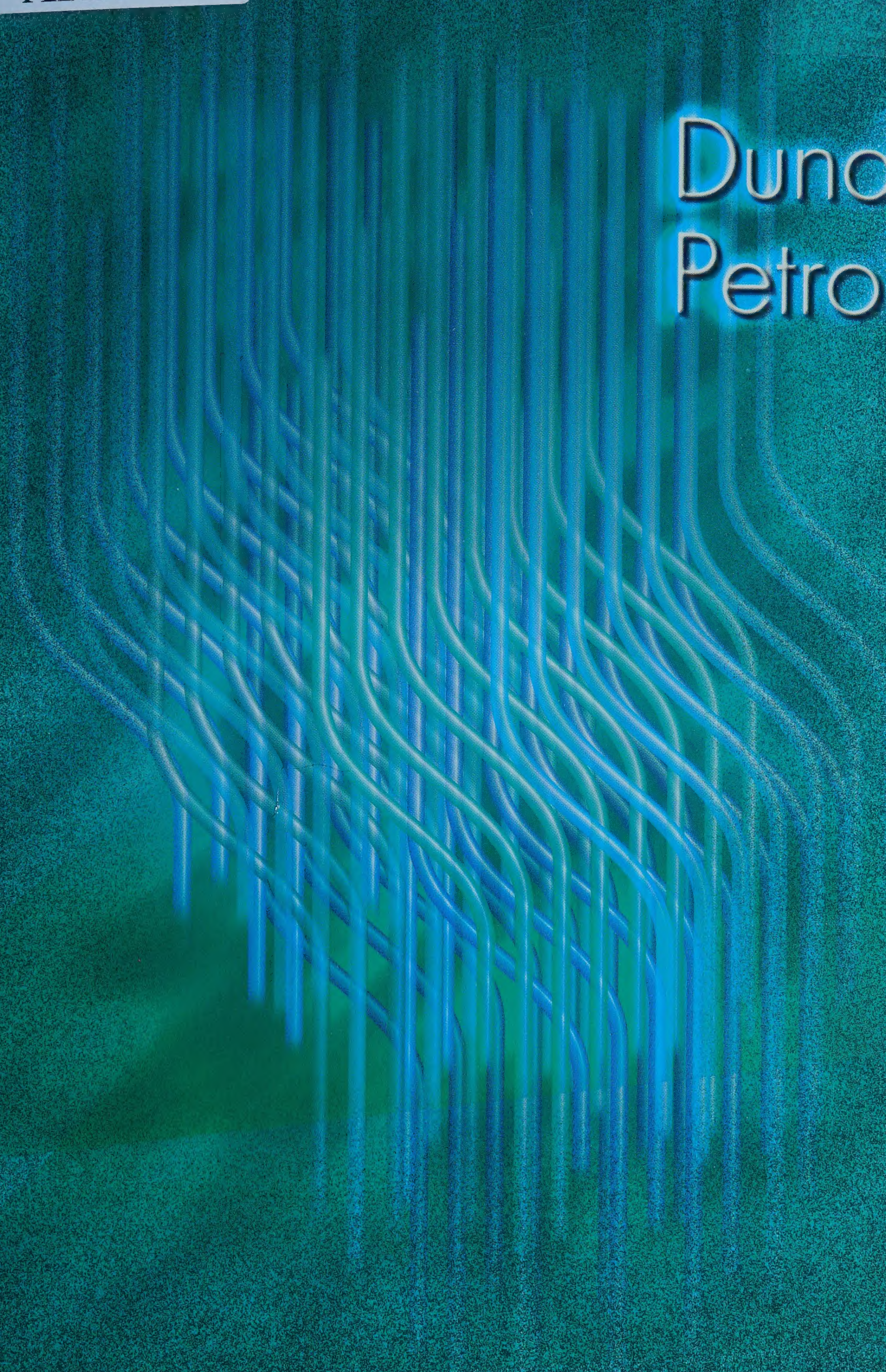
AR59

# Dundee Petroleum



1998 ANNUAL REPORT
TO SHAREHOLDERS

## SUMMARY INFORMATION

### FINANCIAL

| | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|
| Gross revenues | $ 1,329,607 | $ 1,513,530 | $ 444,876 | $ 0 |
| Cash flow | 362,996 | 664,347 | 63,929 | (1,556) |
| Cash flow per share | 0.029 | 0.068 | 0.012 | (0) |
| Net income (loss) | (96,329) | 102,888 | 16,108 | (1,634) |
| Net income (loss) per share | (0.008) | 0.011 | 0.003 | (0) |
| Capital expenditures, net | 1,333,555 | 3,418,951 | 797,585 | 780 |
| Total assets | 5,109,331 | 4,198,780 | 1,322,010 | 109,122 |
| Long term debt | 1,999,127 | 1,175,000 | 0 | 0 |
| Shareholders equity | $ 2,361,102 | $ 2,302,202 | $ 975,452 | $ 108,366 |
| Common shares outstanding (Avg) | 12,544,843 | 9,712,415 | 6,005,760 | 2,200,000 |
| Trading price per share ($) | | | | |
| High | 0.38 | 0.74 | 0.40 | NA |
| Low | 0.15 | 0.25 | 0.13 | NA |
| Close | 0.20 | 0.36 | 0.37 | NA |

### OPERATING

| | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|
| Sales | | | | |
| Oil and liquids | $ 554,481 | $ 1,128,775 | $ 444,876 | $ 0 |
| Natural gas | $ 775,126 | $ 384,755 | $ 0 | $ 0 |

### PRODUCTION

| | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|
| Oil and liquids (Bbls) | 31,835 | 44,256 | 16,047 | 0 |
| Oil and liquids price | $ 17.42 | $ 25.51 | $ 27.72 | 0 |
| Natural gas (Mcf) | 377,326 | 211,290 | 0 | 0 |
| Natural gas price | $ 2.05 | $ 1.82 | 0 | 0 |
| Daily production BOE | 191 | 180 | 44 | 0 |
| Reserves (proven and probable) | | | | |
| Oil and liquids (MBbls) | 508 | 552 | 500 | 0 |
| Natural gas (Mmcf) | 13,832 | 2,793 | 0 | 0 |

### WELLS DRILLED

| | | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| Oil | gross | 1 | 3 | 2 | 0 |
| | net | 0.25 | 0.29 | 0.35 | 0 |
| Natural gas | gross | 36 | 0 | 0 | 0 |
| | net | 10.8 | 0 | 0 | 0 |
| Dry | gross | 2 | 1 | 0 | 0 |
| | net | 0.85 | 0.18 | 0 | 0 |

Winspear Business Reference Room
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Edmonton, Alberta T6G 2R6

# Company Profile

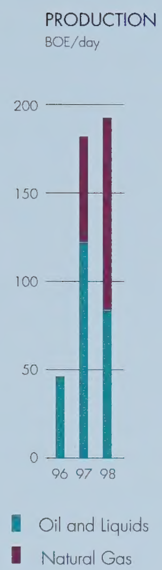
## COMPANY PROFILE

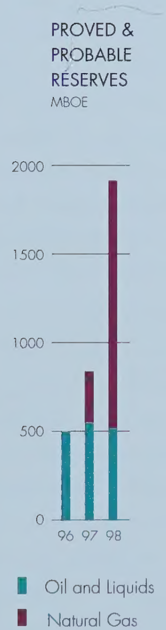
Dundee Petroleum is a Calgary-based, junior energy company engaged in exploration and production of oil and natural gas in Western Canada.

The Company was incorporated in 1995 and listed for trading on the Alberta Stock Exchange in March 1996 as a Junior Capital Pool Corporation.

During 1998, the Company further diversified its reserve base into natural gas, increasing its natural gas reserves by 400% and its land base by 200%. Dundee's reserve and production mix now comprises 70% shallow gas and 30% light oil. The Company's properties have a reserve life index of 17.4 years and are characterized by stable production with significant upside drilling potential. With cumulative finding costs (including all future capital required to develop its reserves) of $5.50 per BOE, annual drilling programs on Dundee's large undeveloped reserve base will provide steady growth on a yearly basis.

The common shares of Dundee currently trade on the Alberta Stock Exchange under the symbol DPC.

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## ON THE COVER

The graphic illustration on the front of this report represents Dundee Petroleum's shift towards natural gas and their extensive drilling of shallow gas wells.

## REPORT TO SHAREHOLDERS – 1998

In what was definitely a "tough" year for the oil and gas industry, Dundee Petroleum weathered the storm with a steady performance and continued reserve growth. With 1998 marked by severely depressed crude oil prices, constrained capital markets and a general disfavour with the oil and gas sector, Dundee managed to further strategically diversify its reserve base into natural gas and position itself for long-term growth and profitability.

During 1998, through an initial 36 well farmin transaction, and a subsequent land acquisition, Dundee established the Cessford shallow gas property as a core area. The drilling and acquisitions at Cessford resulted in Dundee increasing its natural gas reserves by 400% and its land base by 200% in 1998. With the potential for a minimum additional 160 drilling locations at Cessford, Dundee has secured a solid asset which will provide long-life production and a cash flow base, along with drilling opportunities, for years to come.

Dundee's production for 1998 averaged 191 BOE/day, increasing from 180 BOE/day in 1997. Production for the year consisted of 55% natural gas and 45% oil. Natural gas production was attributable to the Company's shallow gas properties located at Cessford and the border area of southwestern Saskatchewan and southeastern Alberta. Oil production was derived primarily from the Company's Arcola, Oungre, Glen Ewen, Bellshill and Killam properties.

As a result of the 36 farmin wells at Cessford coming onstream in September and October, Dundee's production averaged 235 BOE/day in the fourth quarter, consisting of 70% natural gas and 30% oil. This fourth quarter production level represented a 24% increase over the yearly average.

During 1998, Dundee increased its reserve base by 127%, adding a net 1,130,000 BOE to its proved and probable reserves, which replaced yearly production 16 times. These reserve additions resulted from a net increase in natural gas reserves of 400% or 11.4 Bcf, attributable mainly to reserves assigned to the Cessford property.

Capital expenditures for 1998 were $2,133,555 which resulted in a 1998 finding cost of $1.71 per BOE. Including future additional capital required to develop the 1998 reserve additions, estimated at $3,479,000, Dundee's 1998 finding cost was $4.51 per BOE. The Company's three year cumulative finding cost is $5.86 per BOE of proven reserves and $5.51 per BOE of proved and probable reserves, including future additional capital required to develop and bring on-stream its reserves. Dundee's current reserve life index, on a BOE basis, is 17.4 years proven reserves and 22 years total proven and probable reserves.

Revenues for the 1998 fiscal year were $1,329,607, a decrease of $183,923 from 1997. Cash flow from operations was $362,996 or $.029 per share compared with $664,347 or $.068 per share in 1997, which decrease was primarily due to a 32% decrease in crude oil prices received by the Corporation. In 1998, the Corporation recorded a loss of $96,329, compared with net income of $102,888 in 1997. Average sales price for the 1998 fiscal year was $19.11 per BOE, a decrease of 17% or $4 per BOE from the comparative 1997 period. During 1998, oil prices averaging $17.52 per barrel, down 32% from the previous year; however, natural gas prices rose 13% in 1998 to $2.05 per Mcf. Primarily as a result of lower oil prices, the Company's average netback for 1998 was $10.70 per BOE, a decrease of 23% or $3.25 per BOE from the comparative 1997 period.

### OPERATIONS REVIEW

With the downturn in crude oil prices lasting longer than historical cycles, Dundee was successful in its efforts to strategically re-direct a substantial portion of the 1998 budget into natural gas drilling projects. Of most significance, during the second quarter Dundee reached an agreement to farmin and participate in the drilling of 36 shallow gas wells in the Cessford area of southeastern Alberta. This drilling program yielded a 100% success rate, resulting in a new core area characterized by long-life gas reserves with significant upside drilling potential.

Under the farmin arrangement, Dundee was responsible for 30% of the costs of the wells, which were drilled, completed and equipped for production from the Milk River and Medicine Hat formations. In exchange, the Company earned a 30% working interest in the wells and associated lands, comprised of approximately 12,160 gross (3,648 net) acres or 19 gross (5.7 net) sections, subject to a non-convertible gross overriding royalty. Dundee's share of the drilling, completion and tie-in costs for the program was $1,239,245, prior to any capital rebates relating to a commingling agreement (see Cessford property write-up) .

In a subsequent transaction, Dundee reached an agreement in December to purchase an additional 64,640 gross (19,392 net) acres of undeveloped shallow gas acreage directly adjacent to the Company's existing Cessford lands. This acquisition was strategic to Dundee's long-term development of the Cessford area and increased the Company's total landholdings at Cessford to 120 gross (36 net) sections.

The initial 36 wells at Cessford were placed on production in September and October with an initial average production rate of 1.2 Mmcf/day net to Dundee. For the first twelve months, production from these wells is expected to average approximately 800 Mcf/day net to Dundee. Total reserves attributable to Dundee's interest at Cessford are estimated to be 8.53 Bcf proven and 12.14 Bcf proven plus probable.

Finally, at Parkman South, Dundee followed up its discovery well at 11-3-8-33 W1M by completing a two square mile 3D seismic survey over the property in August. After securing the rights

to 1,920 acres of land over the prospect, Dundee (at 60%) and its partner drilled a first stepout well in November. Unfortunately this well came in structurally low and was abandoned. Pending further interpretation of the 3D seismic, the Company has no immediate plans to further develop this prospect.

## DISPOSITIONS REVIEW

In June, Dundee closed the disposition of its minor working interest (3%) in the Hatton shallow gas property for $525,000 cash. Production from this property had averaged 50 Mcf/day net to Dundee, and the sale price represented $0.73 per Mcf on a reserve basis. Proceeds from the sale were used to reduce debt and fund the Cessford drilling program.

In December, Dundee reached an agreement to dispose of its 12.42% working interest in the Horsham shallow gas property located in southwest Saskatchewan for $275,000 cash, also representing $0.73 per Mcf on a reserve basis. Production from the Horsham property averaged 125 Mcf/day net to Dundee. The transaction closed in March of 1999.

## FINANCIAL REVIEW

During 1998, Dundee completed a number of private placement financings, which, in total, consisted of the issuance of 1,816,667 flow-through common shares at a price of $0.30 per share for net proceeds of $545,000. In 1998, the Company also purchased for cancellation 445,000 common shares at an average price of $.25 per share under its Normal Course Issuer Bid. At December 31, 1998, the Company had 13,719,001 common shares outstanding.

For the fiscal year 1998, Dundee expended $2,133,555 for the acquisition of capital assets. The majority of the expenditures were for exploration and development drilling ($1,745,193). The balance of expenditures ($388,362) were incurred on land, seismic, tangible equipment and other assets. In order to finance these expenditures, the Company sourced funds primarily from: the disposition of properties ($800,000), cash flow from operations ($362,000), increase in long term debt ($824,000) and the issuance of share capital ($545,000).

In order to secure a strong and reliable cash flow stream in the near term, the Company contracted 55% of its Cessford gas (600 GJ/day) for the winter contract (November 1, 1998 to March 31, 1999) at an average price of $2.84/GJ ($3/Mcf). In addition, Dundee recently contracted 400 GJ/day of gas at Cessford for the summer contract (April 1, 1999 to July 31, 1999) at a price of $2.37/GJ ($2.50/Mcf).

## OUTLOOK FOR 1999

Dundee's budgeted 1999 drilling and capital program is $1,185,000, of which $830,000 will be directed towards the drilling of approximately 30 development wells at Cessford, commencing in May. These wells are expected to be on production by mid-September, with first year production averaging 750 Mcf/day net to Dundee. The Cessford drilling program will be financed out of existing cash flow and available bank lines. In order to maintain Dundee's debt position within levels of industry norms, the Company may entertain disposing of other minor properties in 1999, should suitable offers be received.

With all new wells at Cessford being commingled from the Milk River and Medicine Hat formations, the economics of drilling in this area are very attractive. Incremental reserves from these wells, on average, are expected to be .21 Bcf. (.063 Bcf net) per well, net to Dundee, from the Medicine Hat and Milk River formations. With total finding and on-stream costs of approximately $5 per BOE at Cessford, annual development drilling programs at Cessford will provide Dundee with steady growth on a yearly basis.

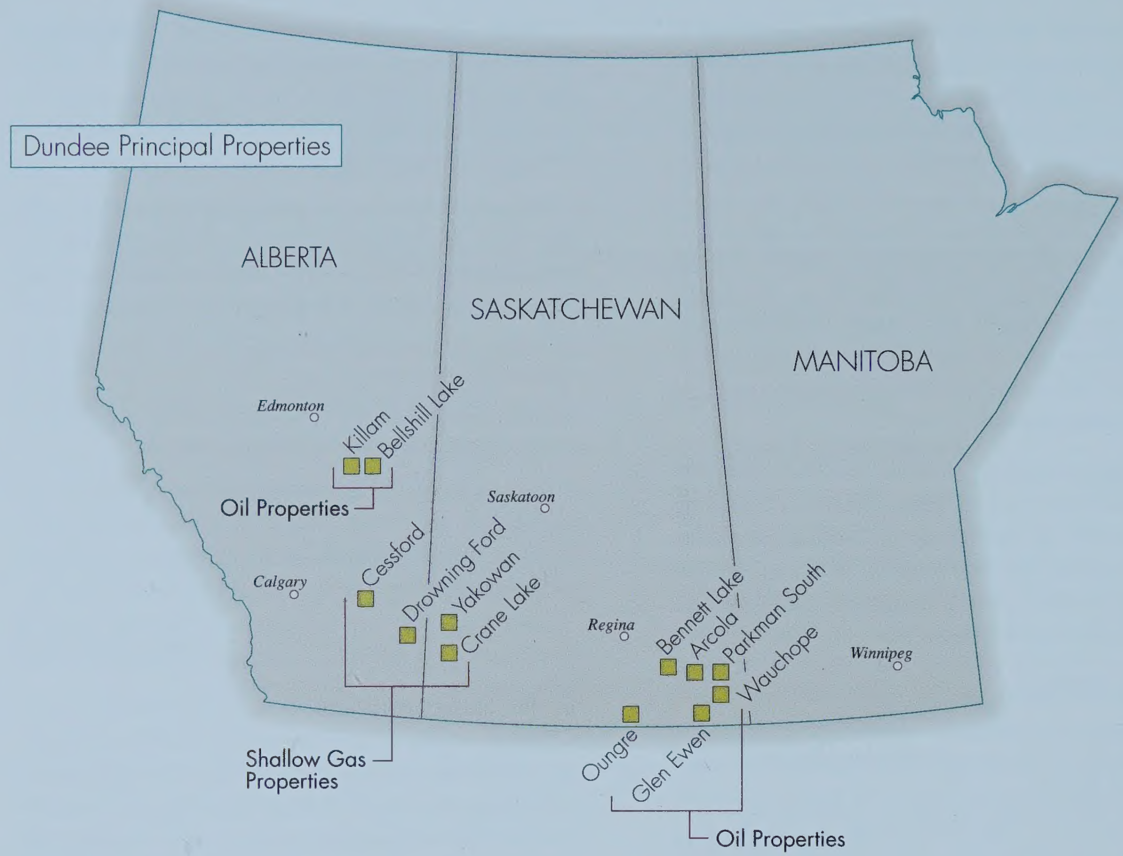
Although Dundee is still positive about the potential of its oil properties at Glen Ewen, Bennett Lake, Parkman South and Wauchope in southeast Saskatchewan, the Company has no capital expenditures allocated to these projects in 1999. However, should the price of crude oil demonstrate a sustained recovery throughout 1999, the Company will then re-evaluate the viability of these projects.

Although management believes that the price of crude oil will likely strengthen somewhat from its 1998 levels, we believe that as a commodity, natural gas offers greater price upside, particularly with increased access to North American markets. Accordingly, as a strategy to provide greater leverage to the shareholders of Dundee, management is currently pursuing additional gas projects in southern Alberta and southwest Saskatchewan. Specifically, in order to complement Dundee's current shallow gas portfolio, the Company is targeting land acquisitions and drilling opportunities which offer a high impact and superior rate of return with limited capital exposure.

The Cessford project has dramatically altered the weighting of Dundee's reserve and production mix, which now comprise approximately 70% natural gas and 30% crude oil. This activity at Cessford, coupled with Dundee's remaining inventory of solid drilling prospects, poises the Company to recognize substantial growth in shareholder value.

I would like to again express my utmost gratitude towards all of the management, directors and shareholders for their support in the continued growth of the Company.

Michael J. Kryczka
President and Chief Executive Officer



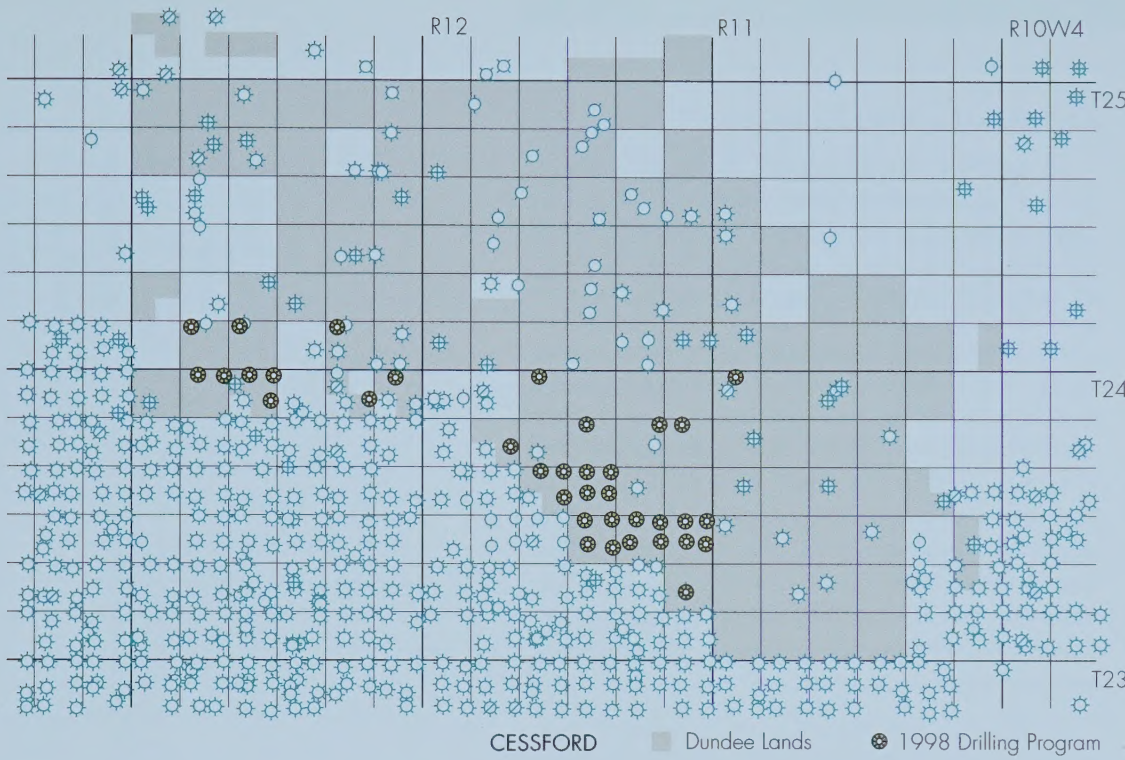

## PROPERTIES

### SHALLOW GAS PROPERTIES

Dundee's natural gas production and reserves are derived from four shallow gas fields located in southeast Alberta and southwest Saskatchewan. The Cessford, Drowning Ford, Yakowan and Crane Lake properties all offer stable production and long-life reserves with significant upside drilling potential.

In its shallow gas core area, the Company holds interests ranging from a gross overriding royalty to a 37.5% working interest covering 134,640 gross (24,448 net) acres. Dundee's net production from these fields averages approximately 1.2 Mmcf/day from 280 gas wells producing from the Medicine Hat and Milk River formations. Reserves attributable to the Company's interest in its shallow gas properties are 13.75 Bcf.

With the establishment of the Cessford property in 1998 as Dundee's main focus area, the Company was able to dispose of its minor interests in a number of shallow gas properties during the year. The Hatton and Horsham properties were sold for $525,000 and $275,000, respectively, which represented unit sale prices of $0.73 per Mcf on a reserve basis. During 1999, Dundee will continue to expand its interest and pursue additional opportunities in its shallow gas core area.




## CESSFORD

The Cessford property was established in 1998 as a result of management's strategy to re-direct a substantial portion of the 1998 budget into natural gas drilling projects. Operations at Cessford commenced during the second quarter when Dundee reached an agreement to farmin and participate in the drilling of 36 shallow gas wells. This drilling program yielded a 100% success rate, resulting in a new core area characterized by long-life gas reserves with significant upside drilling potential.

Under the farmin arrangement, Dundee was responsible for 30% of the costs of the wells, which were drilled, completed and equipped for production from the Milk River and Medicine Hat formations. In exchange, the Company earned a 30% working interest in the wells and associated lands, comprising approximately 12,160 gross (3,648 net) acres or 19 gross (5.7 net) sections, subject to a non-convertible gross overriding royalty.

In a subsequent transaction, Dundee reached an agreement in December to purchase an additional 64,640 gross (19,392 net) acres of undeveloped shallow gas acreage directly adjacent to the Company's existing Cessford lands. This acquisition was strategic to Dundee's long-term development of the Cessford area and increased the Company's total landholdings at Cessford to 76,800 gross (23,040 net) acres or 120 gross (36 net) sections, stretching across 8 townships from Twps. 24-26, Rges. 11-13, W4M.

The initial 36 wells at Cessford were placed on production in September and October with an initial average production rate of 1.2 Mmcf/day net to Dundee. For the first twelve months, production from these wells is expected to average approximately 800 Mcf/day net to Dundee. Of the 36 wells, only 8 wells are currently producing from both the Medicine Hat and Milk River formations. However, it is anticipated that the remaining 28 Medicine Hat wells will be commingled with the Milk River during 1999, with the net result being an equalization and capital rebate to Dundee of $250,000. Dundee's share of the drilling, completion and tie-in costs for the 1998 program was $1,239,245, prior to any capital rebates relating to a commingling agreement.

The Cessford property contains the potential for a minimum additional 160 wells (100 proved; 60 probable), representing total reserves attributable to Dundee's interest of 8.53 Bcf proven and 12.14 Bcf proven plus probable. For 1999, the Company has budgeted $830,000 towards the drilling of approximately 30 development wells at Cessford, commencing in May. These wells are expected to be on production by mid-September, with first year production averaging 750 Mcf/day net to Dundee, increasing Dundee's total net production at Cessford to approximately 1.5 Mmcf/day.

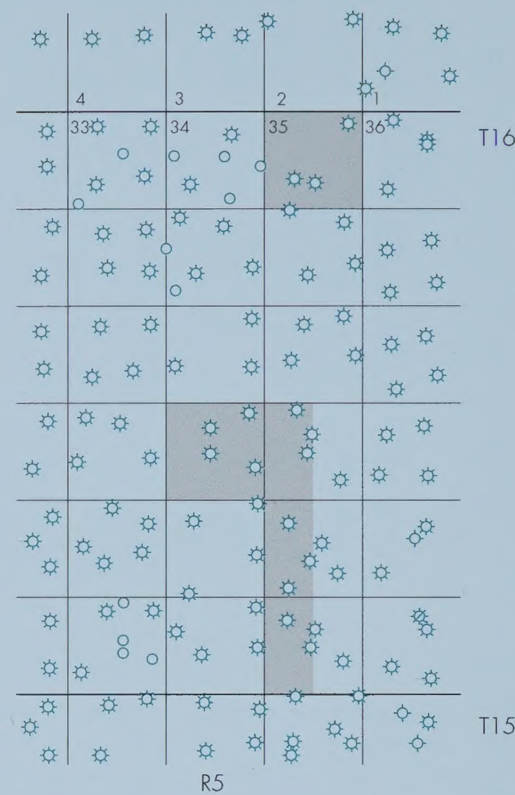
With all new wells at Cessford being commingled from the Milk River and Medicine Hat formations, the economics of drilling in this area are very attractive. Incremental reserves from these wells, on average, are expected to be .21 Bcf (.063 Bcf net) per well, net to Dundee, from the Medicine Hat and Milk River formations. With total finding and on-stream costs of approximately $5 per BOE at Cessford, annual development drilling programs at Cessford will provide Dundee with steady growth on a yearly basis.

## DROWNING FORD/YAKOWAN

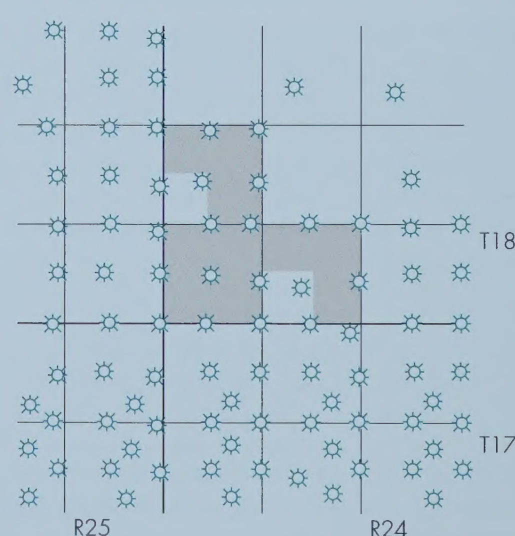
The Drowning Ford and Yakowan shallow gas properties are both characterized by stable, long-life production with upside drilling potential. The Company is currently evaluating the drilling of additional development wells in 1999. Operating costs on both properties average $0.60 per Mcf.

The Drowning Ford property in Alberta is located in Twp. 16, Rge. 5 W4M. The Company holds a 20% working interest in 2,240 gross (448 net) acres, containing 13 wells currently producing natural gas from the Medicine Hat and Milk River formations. During 1998, production from the property averaged 990 Mcf/day or 200 Mcf/day net to Dundee. The property has average cumulative production to-date of over 1 Bcf per well. Remaining proven producing reserves are 0.85 Bcf net to Dundee. With offsetting lands currently being successfully downspaced to 80 acres, the potential exists for the drilling of an additional 10 wells on the property.

The Yakowan property in Saskatchewan is located in Twp. 18, Rge. 24 W3M. The Company holds a 37.5% working interest in 1,600 gross (600 net) acres, containing 10 wells currently producing natural gas from the Milk River formation. Production from the property averages 485 Mcf/day or 182 Mcf/day net to Dundee. Remaining proven producing reserves are 0.44 Bcf net to Dundee. With offsetting lands successfully downspaced to 80 acres, the potential exists for the drilling of an additional 10 wells on the property.




DROWNING FORD　Dundee Lands

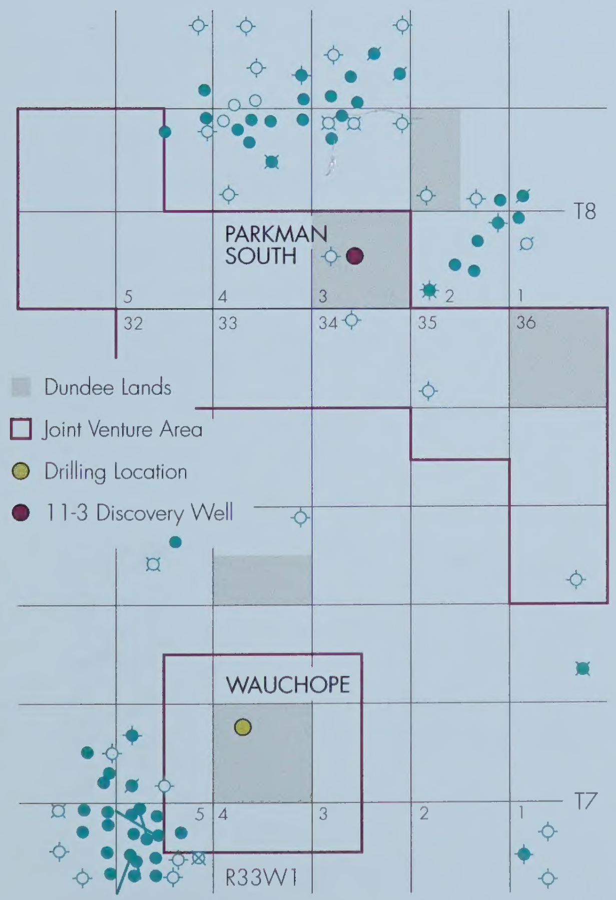



YAKOWAN　Dundee Lands

## PARKMAN SOUTH/WAUCHOPE

At Parkman South, Dundee holds a 25% to 60% working interest in 960 gross (384 net) acres. In March of 1998, Dundee and its partner drilled a discovery well in the Lower Tilston formation at 11-3-8-33 W1M. Dundee, as Operator, followed up the 11-3 discovery by completing a two square mile 3D seismic survey over the property in August. After securing the rights to 1,920 acres of land over the prospect, Dundee (at 60%) and its partner drilled a first stepout well in November. Unfortunately this well came in structurally low and was abandoned. Pending further interpretation of the 3D seismic, the Company has no immediate plans to further develop this prospect.

At Wauchope, 3D seismic indicates a highly prospective Upper Tilston structure. Dundee currently holds a 100% interest in 480 acres over this exploration prospect. Due to the downturn in crude oil prices in 1998, the drilling of the first well on this play has been deferred until commodity prices improve and stabilize.




## LANDS

In 1998, Dundee increased its net land holdings by 20,326 acres or 200%, bringing the Company's total net land holdings to 30,675. Net undeveloped acreage increased 310% in 1998 from 6,645 acres to 27,239 acres. Included in these totals are a significant land acquisition at Cessford which was finalized in December, 1998, but consummated subsequent to year-end (ie: March of 1999).

Assigning an in-house acreage value of $30 per acre, the value of Dundee's undeveloped land is estimated at $817,000.

The majority of Dundee's acreage increases in 1998 were the result of the establishment of the Cessford property, where the Company now holds a 30% interest in 76,800 gross (23,040 net) acres prospective for shallow gas, of which 21,312 net acres are undeveloped. Through the initial 36 well farmin transaction at Cessford in June of 1998, Dundee initially earned 12,160 gross (3,648 net) acres. In a subsequent transaction, Dundee reached an agreement in December to purchase an additional 64,640 gross (19,392 net) acres of undeveloped shallow gas acreage directly adjacent to the Company's existing Cessford lands. This acquisition was strategic to Dundee's long-term development of the Cessford area and increased the Company's total landholdings at Cessford to 120 gross (36 net) sections.

In addition to Cessford, during 1998 the Company added strategic acreage at Wauchope and Parkman South. During 1998, land expiries totaled 1435 gross (367.6 net) acres.

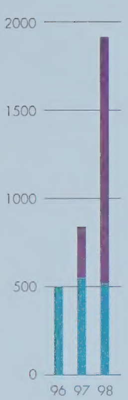
NET LAND HOLDINGS
(1000's Acres)


## 1998 ACREAGE TOTALS

| | Total Acres Gross | Total Acres Net | Developed Acres Net | Undeveloped Acres Net |
|---|---|---|---|---|
| Oil | 19,453 | 6,563 | 636 | 5,927 |
| Gas | 135,920 | 24,112 | 2,800 | 21,312 |
| Total | 155,373 | 30,675 | 3,436 | 27,239 |

## RESERVES

PROVED & PROBABLE RESERVES MBOE




During 1998, the composition of Dundee's reserve base underwent a 180 degree shift from oil to natural gas. In a strong gas market, Dundee's reserve base now comprises 70% natural gas and 30% crude oil. An independent engineering appraisal of the Company's oil and gas reserves at January 1, 1999, has determined the value of the Company's reserves, using a 15% discount rate, to be $7,686,000, an increase of 53% from the previous year.

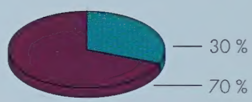
Dundee's total reserves at 1998 year end were 13.83 billion cubic feet of natural gas and 508,000 barrels of crude oil. During 1998, Dundee increased its total reserves by 127% to 1.89 million barrels of oil equivalent. The majority of Dundee's reserve gains were attributable to a 400% or 11.4 Bcf increase in the Company's natural gas reserves as a result of the establishment of the Cessford shallow gas property in 1998.

Capital expenditures in 1998 amounted to $2,133,555 resulting in Finding Costs (including revisions) of $2.41 per BOE of proven reserves and $1.71 per BOE of proven and probable reserves. These 1998 Finding Costs were particularly low due to the large number of proven undeveloped reserves booked at Cessford in 1998. Taking into consideration future additional capital required to develop the 1998 reserve additions, estimated at $3,479,000, Dundee's 1998 finding costs were $4.83 per BOE of proven reserves and $4.51 per BOE of proven and probable reserves. The Company's three year cumulative finding cost is $5.86 per BOE of proven reserves and $5.51 per BOE of proved and probable reserves, including future additional capital required to develop and bring on-stream its reserves.

Property dispositions in 1998 totaled $800,000, representing an average unit sale price of $7.30 per BOE on a reserve basis. After taking into account these property dispositions, the Company's three year cumulative Finding Costs are reduced to $5.73 per BOE of proven reserves and $5.43 per BOE of proven and probable reserves.

Dundee's Reserve Replacement Ratio, being the ratio of net reserve additions (after dispositions) to 1998 production was 11.2. The Company's Recycle Ratio being the average cash flow netback per BOE ($10.70) divided by the Finding Cost per BOE, including future capital required, was 2.37 for 1998. Dundee's Reserve Life Index, based on a fourth quarter annualized production rate, is 17.4 years for proven reserves and 22 years for proven plus probable reserves.

RESERVE DISTRIBUTION




## RESERVE SUMMARY (JANUARY 1, 1999)

| | Reserves | | Estimated Net Present Value Before Tax at (000's) | | | |
|---|---|---|---|---|---|---|
| | Oil & Liquids (MBbls) | Natural Gas (Mmcf) | 0% | 10% | 15% | 20% |
| Proven Developed | | | | | | |
| Producing | 140.4 | 4,105 | $7,158 | $4,257 | $3,541 | $3,041 |
| Non-Producing | 18.7 | - | 188 | 120 | 100 | 85 |
| Proven Undeveloped | 320.5 | 6,049 | 9,265 | 4,272 | 3,027 | 2,173 |
| Total Proven | 479.6 | 10,154 | 16,611 | 8,649 | 6,668 | 5,299 |
| Probable | 28.5 | 3,678 | 4,826 | 1,647 | 1,018 | 644 |
| Total Proven & Probable | 508.1 | 13,832 | $21,437 | $10,296 | $7,686 | $5,943 |

## 1998 RESERVE RECONCILIATION

| | Oil & Liquids (MBbls) | | | Natural Gas (Mmcf) | | | Total Equivalents (MBOE) | | |
|---|---|---|---|---|---|---|---|---|---|
| | Proven | Probable | Total | Proven | Probable | Total | Proven | Probable | Total |
| At January 1, 1998 | 524 | 28 | 552 | 2,580 | 213 | 2,793 | 782 | 50 | 832 |
| Additions | 7 | - | 7 | 8,532 | 3,608 | 12,140 | 860 | 361 | 1,221 |
| Dispositions | (2) | - | (2) | (994) | (143) | (1,137) | (101) | (14) | (115) |
| Revisions | (17) | - | (17) | 413 | - | 413 | 24 | - | 24 |
| Production | (32) | - | (32) | (377) | - | (377) | (70) | - | (70) |
| At January 1, 1999 | 480 | 28 | 508 | 10,154 | 3,678 | 13,832 | 1,495 | 397 | 1,892 |

## RESERVE REPLACEMENT

| | Proven | | Proven & Probable | |
|---|---|---|---|---|
| (MBOE) | 1998 | 1997 | 1998 | 1997 |
| Net Reserve Additions | 783 | 462 | 1,130 | 390 |
| Annual Production | 70 | 66 | 70 | 66 |
| Reserves Replacement Ratio | 11.2 | 7.0 | 16.1 | 5.9 |

## ANNUAL FINDING & DEVELOPMENT COSTS

| Year Ended December 31 | 1998 | 1997 | 1996 |
|---|---|---|---|
| Total Capital Expenditures ($000's) | 2,133 | 3,419 | 907 |
| Proven Reserve Additions (MBOE) | 884 | 462 | 385 |
| Average Cost Per BOE | $2.41 | $7.40 | $2.36 |
| Proven & Prob. Reserve Additions (MBOE) | 1,245 | 390 | 500 |
| Average Cost Per BOE | $1.71 | $8.77 | $1.81 |

## 1998 ANNUAL FINDING & DEVELOPMENT COSTS

(Including future additional capital costs required to develop reserves)

| | 1998 |
|---|---|
| Proven Reserves | |
| Capital Expenditures 1998 ($000's) | 2,133 |
| Future Expenditures Required ($000's) | 2,133 |
| Total Capital Expenditures ($000's) | 4,266 |
| Proven Reserve Additions (MBOE) | 884 |
| Average Cost Per BOE | $4.83 |
| Proven & Probable Reserves | |
| Capital Expenditures 1998 ($000's) | 2,133 |
| Future Expenditures Required ($000's) | 3,479 |
| Total Capital Expenditures ($000's) | 5,612 |
| Proven & Probable Reserve Additions (MBOE) | 1,245 |
| Average Cost Per BOE | $4.51 |

## CUMMULATIVE FINDING & DEVELOPMENT COSTS

| | 1996 to 1998 |
|---|---|
| Total Capital Expenditures ($000's) | 6,459 |
| Proven Reserve Additions (MBOE) | 1,731 |
| Average Cost per BOE | $3.73 |
| Proven & Probable Reserve Additions (MBOE) | 2,135 |
| Average Cost per BOE | $3.03 |

## CUMMULATIVE FINDING & DEVELOPMENT COSTS

(Including future additional capital costs required to develop reserves)

| | 1996 to 1998 |
|---|---|
| Proven Reserves | |
| Capital Expenditures 1996 - 1998 ($000's) | 6,459 |
| Future Expenditures Required ($000's) | 3,686 |
| Total Capital Expenditures ($000's) | 10,145 |
| Proven Reserve Additions (MBOE) | 1,731 |
| Average Cost per BOE | $5.86 |
| Proven & Probable Reserves | |
| Capital Expenditures 1996 - 1998 ($000's) | 6,459 |
| Future Expenditures Required ($000's) | 5,308 |
| Total Capital Expenditures ($000's) | 11,767 |
| Proven & Probable Reserve Additions (MBOE) | 2,135 |
| Average Cost per BOE | $5.51 |

## ANNUAL RESERVE RECYCLE RATIO

| | 1998* | 1997 | 1996 |
|---|---|---|---|
| Total Proven | 2.22 | 1.89 | 5.09 |
| Total Proven & Probable | 2.37 | 1.59 | 6.64 |

*(Includes Future Additional Capital Costs Required To Develop Reserves)

## RESERVE LIFE INDEX

(Years of reserves remaining at 1998 fourth quarter annualized production rate)

| | Proven | Proven & Probable |
|---|---|---|
| Oil | 17.9 | 18.9 |
| Natural Gas | 17.2 | 23.5 |
| BOE | 17.4 | 22.0 |

## NET ASSET VALUE

| ($ 000's) | 10% Dcf | 15% Dcf |
|---|---|---|
| Total Proven | 8,649 | 6,668 |
| Probable | 1,647 | 1,018 |
| Total Proven & Probable | 10,296 | 7,686 |
| Undeveloped Land | 817 | 817 |
| Current Debt & Working Capital (Dec/98) | (1,543) | (1,543) |
| Total | 9,570 | 6,960 |
| Net Asset Value per Share | $0.70 | $0.51 |

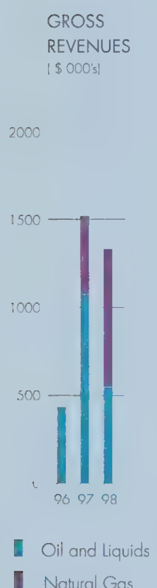
## PRICING FORECAST

| Year | Crude Oil WTI Cushing Oklahoma ($US/Bbl) | Crude Oil Edmonton Par 40 API ($Cdn./Bbl) | Natural Gas Alberta ($/Mmbtu) |
|---|---|---|---|
| 1999 | 14.75 | 21.29 | 2.20 |
| 2000 | 16.50 | 23.23 | 2.20 |
| 2001 | 18.15 | 25.57 | 2.24 |
| 2002 | 19.96 | 26.03 | 2.29 |
| 2003 | 20.46 | 26.70 | 2.33 |
| 2004 | 20.97 | 27.40 | 2.38 |
| 2005 | 21.39 | 27.96 | 2.43 |
| 2006 | 21.82 | 28.54 | 2.48 |
| 2007 | 22.25 | 29.13 | 2.53 |
| 2008 | 22.70 | 29.73 | 2.58 |
| 2009 | 23.15 | 30.34 | 2.63 |
| 2010 | 23.61 | 30.96 | 2.68 |

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### OIL AND GAS REVENUE

Dundee's oil and gas revenue before royalties were $1,329,607 for the year ended December 31, 1998 as compared to $1,513,530 for 1997. The decrease of 12% is attributable to a decrease in oil sales of $574,294 offset by an increase in natural gas sales of $390,371. Total production increased 6% from 65,385 BOE in 1997 to 69,569 BOE in 1998. The ratio of gas production to total production increased from 32% in 1997 to 54% in 1998. In 1998, the average selling price for crude oil and natural gas liquids was $19.11 per BOE, down 17% from an average of $23.04 per BOE in 1997. Natural gas averaged $2.05/Mcf and oil averaged $17.42/Bbl.




Based on the Company's proposed 1999 drilling program, production volumes and revenues will increase significantly in 1999. With the drilling of 30 shallow gas wells at Cessford, Alberta, Dundee will increase it's daily production from a 1998 exit rate of 230 BOE to 300 BOE when the wells come onstream in the fall of 1999.

### ROYALTIES

Dundee's royalties (net of ARTC) on oil and gas production were $172,919 for the year ended December 31, 1998 as compared to $262,316 for the previous year. In 1998 royalties averaged $2.49 per BOE a decrease of 38% from $3.99 per BOE in 1997. The decrease in the royalty rate is attributable to new gas production in Alberta which has lower royalty rates and is eligible for the ARTC.

### PRODUCTION EXPENSE

Dundee's oil and gas production expenses were $412,316 for the year ended December 31, 1998 as compared to $339,126 for the previous year. The increase of $73,190 or 22% is attributable to a overall production increase of 6%, as well as general increases in field expenses. As a percentage of gross oil and gas revenues, production expenses were 31%, and averaged $5.93 per Barrel of oil equivalent.

### GENERAL AND ADMINISTRATIVE

The Company's general and administrative expenses for the year ended December 31, 1998 were $258,029 as compared to $209,307 in 1997. G&A expenses averaged $3.71/BOE in 1998 as compared to $3.19/BOE in 1997. Based on estimated net production increases and overall cost rationalization plans the Company expects to decrease G&A per BOE to below $3.00 in 1999.

### INTEREST EXPENSE

Dundee's interest expense for the year ended December 31, 1998 was $123,347 as compared to $41,996 for the previous year. The increase of $81,351 is attributable to the increase in long term debt from $1,175,000 at year end 1997 to $1,999,127 at year end 1998.

### DEPLETION AND AMORTIZATION

The Company's depletion and amortization expense for the year ended December 31, 1998 was $459,325 as compared to $477,459 in the previous year. The corporate depletion rate was 5.13% in 1998 as compared to 7.7% in 1997. The decrease in depletion rate is due to the increase in proven reserves from 782,000 BOE at December 31, 1997 to 1,495,000 BOE at December 31, 1998.

### CASH FLOW FROM OPERATIONS

Dundee's operating cash flow for the year ended December 31, 1998 was $362,996 as compared to $664,347 for the previous year. The decrease of $301,351 is mainly due to a decrease in average sales price per BOE (due to lower crude oil prices), as well as increases in production expenses, general and administrative expenses and interest expense. The corporate average net back decreased from $10.11/BOE in 1997 to $5.22/BOE in 1998.

With a higher weighting to natural gas and estimated production increases, the Company expects corporate net backs to increase significantly in 1999.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital at December 31, 1998 was $280,448 as compared to $61,651 at the end of the previous year. The increase of $218,797 is attributable mainly to an account receivable at year end of $275,000 on a property disposition.

## CAPITAL EXPENDITURES

| | 1998 |
|---|---|
| Land and lease | $ 31,736 |
| Drilling and completion | 1,745,193 |
| Facilities and equipment | 353,132 |
| Other fixed assets | 3,495 |
| Total | $ 2,133,555 |

## CAPITAL DISPOSITIONS

| | 1998 |
|---|---|
| Land and lease | $ 640,000 |
| Facilities and equipment | 160,000 |
| Total | $ 800,000 |

## YEAR 2000 (Y2K) STATUS

The corporation has addressed the Y2K computer issue, being the ability of computer hardware and software and embedded chips to properly function and process data during the 20th to 21st Century change. The Corporation is satisfied that its internal systems and those of its direct service providers, such as accounting services, are Y2K compliant. In addition, the Corporation is satisfied that field equipment operated by it is Y2K compliant. The Corporation has not obtained satisfactorily unqualified advice from the operators of its non operated properties that the operators' systems and operated field equipment are Y2K compliant; nor has the Corporation obtained satisfactorily unqualified advice from the buyers of its production and major processors and transporters that their systems and equipment are Y2K compliant. In addition, the operations of the Corporation, both operated and non operated may be affected by interruptions in basic services such as electricity and telephone which are beyond the ability of the Corporation to assess. The Corporation currently has no reason to believe that its costs associated with Year 2000 compliance for its operated systems will be significant but is unable to assess potential costs for Y2K compliance of non operated systems. The Corporation is unable to fully determine the consequences to the Corporation if the applications of the operators of its non operated properties, product processors, buyers, transporters or suppliers of basic services are not Y2K compliant. The potential impact of such applications not being compliant could range from inconvenience, such as delay in the receipt of revenues, to a complete shut down of production for an indeterminable period. The Corporation is unable to economically insure against all possible losses from Y2K non compliance.

## BUSINESS RISKS

Dundee's operations are conducted in Western Canada and involve certain business risks. These risks include the uncertainty of replacing annual production and finding new reserves on an economic basis, and the instability of commodity prices, foreign exchange rates and interest rates. Dundee manages these risks by employing highly trained and competent management who carry out the following corporate strategies:

- Balance production portfolio between oil and gas
- Pursue low risk development projects and moderate risk exploration plays in the Company's core areas
- Acquisition of producing assets with significant upside development potential
- Maintain low finding, operating and general and administrative costs

In order to secure a strong and reliable cash flow stream in the near term, the Company contracted 55% of its Cessford natural gas (600 GJ/day) for the winter contract (November 1, 1998 to March 31, 1999) at an average price of $2.84/GJ ($3/Mcf). In addition, Dundee recently contracted 400 GJ/day of gas at Cessford for the summer contract (April 1, 1999 to July 31, 1999) at a price of $2.37/GJ ($2.50/Mcf).

With natural gas production expected to increase significantly in 1999, management will continue to review the Company's hedging positions and may engage in further hedging at suitable prices.

## OUTLOOK FOR 1999

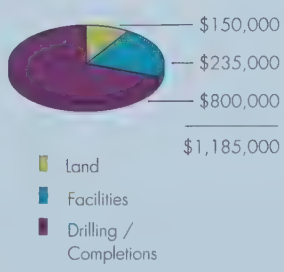
Dundee's budgeted 1999 drilling and capital program is $1,185,000, of which $830,000 will be directed towards the drilling of approximately 30 development wells at Cessford, commencing in May. These wells are expected to be on production by mid-September, with first year production averaging 750 Mcf/day net to Dundee.

Based on 100% drilling success at Cessford, commodity pricing of $2.25/Mcf for natural gas and $17.50 Cdn/Bbl for oil, the Company forecasts 1999 cash flow of $600,000 or $.044 per share. Using increased commodity prices of $2.50/Mcf for natural gas and $22.00 Cdn/Bbl for crude oil, 1999 cash flow is forecast to be $865,000 or $.064 per share.

The Cessford drilling program will be financed out of existing cash flow and available bank lines. In order to maintain Dundee's debt position within levels of industry norms, the Company may entertain disposing of other minor properties in 1999, should suitable offers be received.

With all new wells at Cessford being commingled from the Milk River and Medicine Hat formations, the economics of drilling in this area are very attractive. Incremental reserves from these wells are, on average, expected to be .21 Bcf. (.063 Bcf net) per well, net to Dundee, from the Medicine Hat and Milk River formations. With total finding and on-stream costs of approximately $5 per BOE at Cessford, annual development drilling programs at Cessford will provide Dundee with steady growth on a yearly basis.

1999 CAPITAL BUDGET



## MANAGEMENT'S REPORT

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial operating data contained elsewhere in the report. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly the Company's financial position and results of operations, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the financial statements.

Management has established and maintains a system of internal control which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that financial information is reliable and accurate.

The financial statements have been examined by external auditors appointed by the shareholders. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition.

The Audit Committee of the Board of Directors, has reviewed in detail the financial statements with management and the external auditors. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

Michael J. Kryczka

President & Chief Executive Officer

Hugh M. Thomson

Vice President, Finance &

Chief Financial Officer

## AUDITOR'S REPORT

I have audited the consolidated balance sheets of DUNDEE PETROLEUM CORP. as at December 31, 1998 and 1997 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998 and 1997 and the results of its operations and the changes in its cash flows for the years then ended in accordance with generally accepted accounting principles.

Stan Peloski

Chartered Accountant

Calgary, Alberta, March 29, 1999

## DUNDEE PETROLEUM CORP.

## CONSOLIDATED BALANCE SHEETS

As at December 31

| | Note | 1998 | 1997 |
|---|---|---|---|
| | | $ | $ |
| **ASSETS** | | | |
| Current | | | |
| Cash | | - | 23,707 |
| Marketable securities | | - | 110,000 |
| Accounts receivable | 8 | 700,276 | 290,136 |
| Prepaid expenses and deposits | | 39,867 | 34,979 |
| | | 740,143 | 458,822 |
| Property and Equipment | 3 | 4,369,188 | 3,739,958 |
| | | 5,109,331 | 4,198,780 |
| **LIABILITIES** | | | |
| Current | | | |
| Accounts payable and accrued | 8 | 284,695 | 297,171 |
| Current maturities on long-term debt | | 175,000 | 100,000 |
| | | 459,695 | 397,171 |
| Long-Term Debt | 4 | 1,824,127 | 1,075,000 |
| Future Site Restoration and Abandonment | 3 | 75,000 | 35,000 |
| Deferred Income Taxes | | 389,407 | 389,407 |
| | | 2,748,229 | 1,896,578 |
| **SHAREHOLDERS' EQUITY** | | | |
| Share Capital | 5 | 2,340,069 | 2,184,840 |
| Retained Earnings | | 21,033 | 117,362 |
| | | 2,361,102 | 2,302,202 |
| | | 5,109,331 | 4,198,780 |

ON BEHALF OF THE BOARD:

Michael J. Kryczka
Director

Hugh M. Thomson
Director

DUNDEE PETROLEUM CORP.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

For the years ended December 31

| | Note | 1998 | 1997 |
|---|---|---|---|
| | | $ | $ |
| **REVENUE** | | | |
| Petroleum and natural gas sales | | 1,329,607 | 1,513,530 |
| Royalties | | (200,958) | (268,316) |
| Alberta Royalty Tax Credit | | 28,039 | 6,000 |
| | | 1,156,688 | 1,251,214 |
| **EXPENSES** | | | |
| Operating and production | | 412,316 | 339,126 |
| General and administrative | 8 | 258,029 | 209,307 |
| Interest | | 123,347 | 38,434 |
| Depletion and amortization | | 459,325 | 477,459 |
| | | 1,253,017 | 1,064,326 |
| Income (loss) before income taxes | | (96,329) | 186,888 |
| DEFERRED INCOME TAXES | 6 | - | 84,000 |
| NET INCOME (LOSS) | | (96,329) | 102,888 |
| Retained Earnings, beginning of year | | 117,362 | 14,474 |
| RETAINED EARNINGS, END OF YEAR | | 21,033 | 117,362 |
| NET INCOME (LOSS) PER SHARE | 5 | | |
| Basic | | (0.008) | 0.011 |
| Fully Diluted | | (0.007) | 0.008 |

DUNDEE PETROLEUM CORP.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31

| | Note | 1998 | 1997 |
|---|---|---|---|
| | | $ | $ |
| **OPERATING** | | | |
| Net income (loss) | | (96,329) | 102,888 |
| Items not affecting cash flow | | | |
| Depletion and amortization | | 459,325 | 477,459 |
| Deferred income taxes | | - | 84,000 |
| Funds provided by operations | | 362,996 | 664,347 |
| Changes in non-cash working capital items | 7 | 44,069 | (45,691) |
| | | 407,065 | 618,656 |
| **FINANCING** | | | |
| Advances on bank credit facilities | | 1,027,344 | 875,000 |
| Repayment of bank credit facilities | | (75,000) | - |
| Issuance (repayment) of promissory note payable | 1(a) | (100,000) | 300,000 |
| Reduction in promissory note payable | 1(a) | (28,217) | - |
| Issuance of share capital | | 440,229 | 1,223,862 |
| | | 1,264,356 | 2,398,862 |
| **INVESTING** | | | |
| Acquisition of subsidiary net assets | 1(a) | - | (2,000,000) |
| Acquisition of property and equipment | | (2,133,555) | (1,289,905) |
| Proceeds of disposal of property and equipment | | 800,000 | - |
| Changes in non-cash working capital items | 7 | (361,573) | (193,224) |
| | | (1,695,128) | (3,483,129) |
| **DECREASE IN CASH** | | (23,707) | (465,611) |
| Cash and cash equivalents, beginning of year | | 23,707 | 489,318 |
| **CASH, END OF YEAR** | | - | 23,707 |
| **CASH FLOW FROM OPERATIONS PER SHARE** | 5 | | |
| Basic | | 0.029 | 0.068 |
| Fully Diluted | | 0.026 | 0.055 |

DUNDEE PETROLEUM CORP.
Notes to Consolidated Financial Statements
December 31, 1998 and 1997

## 1. THE CORPORATION

Dundee Petroleum Corp. (the Corporation) was incorporated on August 17, 1995, under the Business Corporations Act (Alberta) and is publicly traded on the Alberta Stock Exchange. The Corporation's principal activity is the exploration for and development of petroleum and natural gas.

The consolidated financial statements of the Corporation have been prepared by management in accordance with accounting principles generally accepted in Canada and include the accounts of the Corporation and its wholly-owned subsidiary.

### (a) BUSINESS COMBINATION

Effective July 1, 1997 the Corporation acquired all of the issued shares of Kenesen Resources Ltd. (Kenesen) for $2,000,000. The transaction has been recorded using the purchase method on the basis that the Corporation is the acquirer. The purchase price and consideration were allocated as follows:

| | $ |
|---|---|
| Purchase price | |
| Working capital | 163,361 |
| Property and equipment | 2,129,046 |
| Deferred income taxes payable | (292,407) |
| | 2,000,000 |
| Consideration | |
| Cash | 1,500,000 |
| Promissory note payable [Note 4] | 300,000 |
| Issuance of 500,000 common voting shares at $0.40 per share [Note 5(b)] | 200,000 |
| | 2,000,000 |

During the year ended December 31, 1998, a price adjustment of $28,217 was recorded through a reduction in the promissory note payable. This adjustment was based upon a shortfall in working capital available in Kenesen at the closing date of the transaction.

Supplemental pro-forma information reflecting the results of operations, for the year ended December 31, 1997, as though the companies had combined at the beginning of the year is presented in Note 12.

On January 31, 1998, Kenesen was wound-up into the Corporation.

### (b) PARTNERSHIP OPERATIONS

Effective October 1, 1997, the Corporation and Kenesen transferred all of their petroleum and natural gas properties to the Dundee Petroleum Partnership (the Partnership). These consolidated financial statements reflect the operations of the Partnership from inception. The fiscal year end of the Partnership is June 30.

Supplemental information reflecting the operations of the Partnership, for the period from inception to December 31, 1997, is presented in Note 13. For the year ended December 31, 1998, the Corporation's operations are identical to those of the Partnership for the twelve month period then ended.

Immediately prior to the wind-up referred to in Note 1(a), Kenesen transferred its partnership interest to a new company, Kenesen Petroleum Corp. (KPC), in return for common shares of KPC. As a result of the wind-up, KPC became a wholly-owned subsidiary of the Corporation.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### (a) FINANCIAL INSTRUMENTS

The carrying values of the Corporation's financial assets and liabilities (cash, marketable securities, accounts receivable, accounts payable and accrued and long term debt) approximates their fair market values at December 31, 1998 and 1997.

The Corporation is exposed to credit risk on the accounts receivable from its joint operating partners; however, the risk is mitigated by the ability of the Corporation to offset such amounts against any net production revenue owing to the partners.

The Corporation is also exposed to interest rate risk with respect to its bank credit facilities. Interest thereon is charged at a rate based on prime plus per annum and is accordingly subject to fluctuation.

Financial instruments are periodically used to hedge the Corporation's exposure to commodity price fluctuations on a portion of its petroleum and natural gas production. These instruments are not used for speculative trading purposes and the related gains or losses are recognized in the statement of operations as the underlying transactions are recognized.

### (b) PETROLEUM AND NATURAL GAS PROPERTIES

The Corporation follows the full cost method of accounting for petroleum and natural gas properties whereby all costs associated with the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized and charged against income as set out below. Such costs include lease acquisition, geological and geophysical expenditures, the cost of drilling both productive and non-productive wells, costs of production and gathering equipment, carrying charges on non-producing properties and that portion of general and administrative expenses directly related to acquisition, exploration and development activities. Proceeds received from the disposition of properties are credited against accumulated costs except under circumstances which result in a material change in the rate of depletion, in which case a gain or loss is recorded and reflected in the statement of operations.

Capitalized costs, together with estimated future costs associated with the development of proven reserves are depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas, before royalties, as determined by independent engineers. For purposes of the depletion calculation, petroleum and natural gas reserves are converted to a common unit of measurement based on their relative energy content.

Costs of acquiring and evaluating unproven properties are initially excluded from the depletion calculation. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned, or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The Corporation applies a ceiling test to capitalized costs to ensure that such costs do not exceed the estimated undiscounted value of future net revenues from proven reserves, at prices and operating costs in effect at the year end, plus the cost of unevaluated properties less management's estimate of impairment thereof. This test also provides for estimated future site restoration and abandonment costs, general and administrative costs, financing charges and income taxes that will be incurred in earning these revenues.

### (c) FUTURE SITE RESTORATION AND ABANDONMENT COSTS

Future site restoration and abandonment costs are estimated and recorded over the expected life of the Corporation's petroleum and natural gas reserves, using the unit-of-production method. Costs are based on engineering estimates considering current regulations, costs and industry standards. Actual expenditures incurred are applied against the accumulated provision. The provision is classified as a long-term liability.

(d) AMORTIZATION
Amortization of office equipment is provided using the declining balance method at rates of 20% to 30% per annum.

(e) JOINT OPERATIONS
Substantially all of the Corporation's exploration and development activities are conducted jointly with others and, accordingly, these financial statements reflect only the Corporation's proportionate interest in such activities.

(f) FLOW-THROUGH SHARES
Under the provisions of the Income Tax Act (the "Act"), a corporation may issue shares, the proceeds of which are used to incur "qualifying expenditures" as defined in the Act. The subscriber for these shares, and not the Corporation, is entitled to deduct these "qualifying expenditures" for Income Tax purposes.

Petroleum and natural gas properties and share capital are reduced by the estimated cost of the tax deductions renounced by the Corporation when the qualifying expenditures are incurred.

(g) MEASUREMENT UNCERTAINTY
The amounts recorded for depletion of petroleum and natural gas properties and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proven reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

## 3. PROPERTY AND EQUIPMENT

| | 1998 | | | 1997 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Depletion and Amortization | Net Book Value | Cost | Accumulated Depletion and Amortization | Net Book Value |
| | $ | $ | $ | $ | $ | $ |
| Petroleum and natural gas properties | | | | | | |
| Leases and rights | 648,170 | 232,624 | 415,546 | 1,256,434 | 145,469 | 1,110,965 |
| Exploration and development costs | 3,912,813 | 535,616 | 3,377,197 | 2,452,621 | 250,191 | 2,202,430 |
| Lease and well equipment | 1,177,125 | 630,622 | 546,503 | 983,993 | 587,310 | 396,683 |
| | 5,738,108 | 1,398,862 | 4,339,246 | 4,693,048 | 982,970 | 3,710,078 |
| Office equipment | 47,362 | 17,420 | 29,942 | 43,867 | 13,987 | 29,880 |
| | 5,785,470 | 1,416,282 | 4,369,188 | 4,736,915 | 996,957 | 3,739,958 |

| | 1998 | 1997 |
|---|---|---|
| | $ | $ |
| General and administrative expenses and interest expense capitalized during the year | 165,000 | 89,499 |
| Cost relating to unproven properties excluded from the calculation of depletion and the ceiling test | 53,379 | - |
| Net book value of petroleum and natural gas properties not subject to deduction for income tax purposes as a result of renunciation pursuant to the issuance of flow-through common shares [Note 5(b)] | 668,605 | 355,557 |
| Cumulative charge for future site restoration and abandonment costs | 75,000 | 35,000 |
| Estimated future site restoration and abandonment costs to be recorded | 500,500 | 276,100 |

## 4. LONG-TERM DEBT

| | 1998 | 1997 |
|---|---|---|
| | $ | $ |
| Revolving reducing demand loan | 1,182,344 | 875,000 |
| Non-revolving reducing acquisition loan | 645,000 | - |
| Promissory note payable | 171,783 | 300,000 |
| | 1,999,127 | 1,175,000 |
| less, current maturities | 175,000 | 100,000 |
| | 1,824,127 | 1,075,000 |

(a) NATIONAL BANK OF CANADA CREDIT FACILITIES

i) REVOLVING REDUCING DEMAND LOAN
Bearing interest at the bank's prime rate plus 1% (7.75% at December 31, 1998). The Corporation has arranged a credit facility of a maximum of $1,400,000, reducing by $20,000 per month. At December 31, 1998, the maximum available was $1,260,000.

ii) NON-REVOLVING REDUCING ACQUISITION LOAN
Bearing interest at the bank's prime rate plus 1 1/4% (8% at December 31, 1998). The Corporation has arranged a credit facility of $720,000. Repayments of $25,000 per month were required until March, 1999.

iii) TREASURY RISK LINE
A maximum of $500,000 for use in the management of risk related to interest rates, foreign exchange and commodity prices. No funds have been drawn against this credit facility.

The bank credit facilities are secured by a general assignment of book debts, a first floating charge debenture in the amount of $10,000,000, over all assets of each of the Corporation, its subsidiary and Dundee Petroleum Partnership, negative pledges from the Corporation, its subsidiary and the Partnership to provide fixed charges over producing properties at the request of the bank, guarantees in the amount of $3,000,000 each from the Corporation and Kenesen Petroleum Corp., assignment of material contracts, as applicable, by the Corporation, its subsidiary and the Partnership and assignment of insurance proceeds.

While the credit facilities are demand in nature, the bank has stated that it is not its intention to call for repayment during the next twelve months provided there is no adverse change in the Corporation's financial position. Accordingly, except for the repayments on the non-revolving reducing acquisition loan referred to above, the advances are classified as long-term.

(b) PROMISSORY NOTE PAYABLE

Bearing interest at the rate of 8% per annum and repayable in quarterly installments of $25,000 commencing March 31, 1998. This note relates to the acquisition of the shares of Kenesen Resources Ltd. [Note 1(a)]. During the year ended December 31, 1998, in addition to the scheduled repayments, the note was reduced by $28,217.

Principal repayments of $100,000 in 1999 and $71,783 in 2000 are required under the terms of the note.

## 5. SHARE CAPITAL

(a) AUTHORIZED

Unlimited number of common voting shares
Unlimited number of common non-voting shares
Unlimited number of preferred shares, issuable in series

| (b) ISSUED COMMON VOTING SHARES | NUMBER | AMOUNT |
|---|---|---|
| Balance, December 31, 1996 | 8,261,000 | 960,978 |
| Issued for cash pursuant to private flow-through offerings | 1,486,034 | 613,840 |
| Issued for cash pursuant to public equity offering [Note 5(c)] | 1,584,300 | 712,935 |
| Issued for cash upon exercise of agents' options | 285,000 | 41,000 |
| Issued for cash upon exercise of options under Stock Option Plan | 210,000 | 21,000 |
| Issued upon acquisition of shares of Kenesen Resources Ltd. [Note 1(a)] | 500,000 | 200,000 |
| Issuer repurchase for cancellation | (104,000) | (39,990) |
| Income tax benefits renounced on issuance of flow-through shares [Note 3] | | (205,000) |
| Issuance costs [Note 8] | | (119,923) |
| Balance December 31, 1997 | 12,222,334 | 2,184,840 |
| | | |
| Issued for cash pursuant to private flow-through offerings [Note 9(a)] | 1,816,667 | 545,000 |
| Issued for cash upon exercise of options under Stock Option Plan | 125,000 | 12,500 |
| Issuer repurchase for cancellation | (445,000) | (110,476) |
| Income tax benefits renounced on issuance of flow-through shares [Note 3] | | (285,000) |
| Issuance costs | | (6,795) |
| Balance December 31, 1998 | 13,719,001 | 2,340,069 |

(c) CLASS A WARRANTS

During the year ended December 31, 1997, the Corporation issued 1,584,300 units consisting of one common voting share and one Class A warrant at $0.45 per unit. There was no value attached to the warrants. The Class A warrants entitled the holder to acquire one common voting share, at a price of $0.60 per share, until their expiry on August 1, 1998.

(d) OPTIONS

Pursuant to an Agency Agreement, the Corporation granted an agent, Rogers & Partners Securities Inc., non-transferable options to purchase 158,430 common voting shares at $0.45 per share until February 1, 1999. These options have expired subsequent to December 31, 1998.

The Corporation has a Stock Option Plan (the Plan) for its directors, officers, employees and consultants. During the year ended December 31, 1998 the Corporation granted options, under the Plan, for the purchase of 600,000 common voting shares. At December 31, 1998, there were outstanding options, under the Plan, for the purchase of 1,141,250 common voting shares (1997 - 666,250), as follows:

| Expiry | Granted | Shares Reserved | Exercise Price |
|---|---|---|---|
| December 31, 1999 | 1996 | 55,000 | $0.10 |
| December 31, 1999 | 1996 | 130,000 | $0.20 |
| January 8, 2002 | 1997 | 331,250 | $0.38 |
| January 28, 2002 | 1997 | 25,000 | $0.53 |
| January 29, 2003 | 1998 | 590,000 | $0.31 |
| July 22, 2003 | 1998 | 10,000 | $0.24 |
| | | 1,141,250 | |

Subsequent to December 31, 1998, the Corporation has granted 235,000 additional options under the Plan [Note 10(b)].

(e) ESCROW PROVISIONS

Pursuant to an agreement dated January 8, 1996, 2,200,000 common voting shares, representing the Corporation's seed capital, were held in escrow. At December 31, 1998, 733,333 shares remain in escrow. The Alberta Securities Commission has approved the release of these shares on May 14, 1999.

(f) PER SHARE DATA

Per share data are calculated based on the weighted average number of shares of 12,544,853 (fully diluted - 13,844,523) (1997 - 9,712,415 (fully diluted - 12,121,395)) outstanding during the year.

Cash flow from operations is based upon operating cash flow before changes in non-cash working capital items.

## 6. INCOME TAXES

The provision for income taxes differs from the result which would have been obtained by applying the combined federal and provincial tax rates (approximately 45%) to the Corporation's income (loss) before income taxes. This difference results from the following items:

| | 1998 | 1997 |
|---|---|---|
| | $ | $ |
| Expected income taxes | (44,000) | 84,000 |
| Non-deductible Crown payments | 60,000 | 34,000 |
| Resource allowance | (72,000) | (60,000) |
| Other | 56,000 | 26,000 |
| Deferred income taxes | 0 | 84,000 |

At December 31, 1998, the Corporation has losses, for income tax purposes, available to reduce taxable incomes of future years. If not utilized, these losses will expire as follows:

| | |
|---|---|
| | $ |
| 2002 | 3,000 |
| 2003 | 34,000 |
| 2004 | 99,000 |
| | 136,000 |

At December 31, 1998, the Corporation has the following income tax pools, available to reduce future taxable incomes at the annual rates indicated:

| | | |
|---|---|---|
| | | $ |
| Canadian oil and gas property expense | 10% | 345,000 |
| Canadian development expense | 30% | 478,000 |
| Canadian exploration expense | 100% | 362,000 |
| Undepreciated capital costs | 20% | 598,000 |
| Share issuance costs | 1/5 | 115,000 |
| | | 1,898,000 |

## 7. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

| | 1998 | 1997 |
|---|---|---|
| | $ | $ |
| Marketable securities | 110,000 | (110,000) |
| Accounts receivable | (410,140) | (241,619) |
| Prepaid expenses and deposits | (4,888) | (24,270) |
| Accounts payable and accrued | (12,476) | (26,387) |
| Working capital acquired [Note 1(a)] | - | 163,361 |
| | (317,504) | (238,915) |
| Operating | 44,069 | (45,691) |
| Investing | (361,573) | (193,224) |
| | (317,504) | (238,915) |

## 8. RELATED PARTY TRANSACTIONS

| | 1998 | 1997 |
|---|---|---|
| | $ | $ |
| Management and consulting services paid to officers and/or directors | 202,000 | 155,053 |
| Legal costs paid to a firm of solicitors in which an officer of the Corporation is a partner | | |
| Included in property and equipment | 10,000 | 12,000 |
| Included in share issuance costs | - | 31,693 |
| Included in general and administrative expenses | 24,153 | 18,980 |
| | 34,153 | 62,673 |

At December 31, 1998, accounts receivable include $102,095 due from a company controlled by a director of the Corporation. The amount represents that company's share of capital costs related to properties in which it holds a joint interest with the Corporation and it is subject to the terms and conditions applicable to all of the Corporation's joint interest accounts receivable. Accounts payable include a $25,000 security deposit payable to the same company. This deposit is repayable over the forthcoming year.

## 9. COMMITMENTS

### (a) CAPITAL EXPENDITURES

The Corporation is committed, pursuant to the issuance of flow-through common shares, to incur "qualifying expenditures" in the amount of $545,000 during the forthcoming year. [Note 5(b)]

### (b) HEDGING

The Corporation has entered into a contract to hedge up to 600 gigajoules ("GJ") of natural gas per day, at prices of $2.81 per GJ on the first 450 and $2.915 per GJ on the next 150. The contract is in effect for the winter term commencing November 1, 1998 and ending March 31, 1999. Based on a December 31, 1998 price of $2.52 per GJ, the Corporation's unrecognized settlement gain on this contract amounts to $17,000. The amount recognized by the Corporation is dependent upon prices in effect at the time of settlement.

## 10. SUBSEQUENT EVENTS

Subsequent to December 31, 1998, the Corporation has:

(a) Obtained approval to undertake a normal course issuer bid under which it will acquire, at market price, a maximum of 574,367 common voting shares, representing 4.5% of the issued and outstanding common voting shares of the Corporation, subject to a maximum investment of $229,747.

(b) Obtained approval to reserve an additional 235,000 common voting shares for the granting of options under the Stock Option Plan and has granted options to acquire 235,000 common voting shares of the Corporation at $0.19 per share until January 6, 2004.

## 11. UNCERTAINTY DUE TO THE YEAR 2000

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000 and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

## 12. SUPPLEMENTAL PRO-FORMA INFORMATION

Pro-forma Consolidated Statement of Operations
For the year ended December 31, 1997

| | $ |
|---|---|
| Revenue | |
| Petroleum and natural gas sales, net of royalties | 1,542,493 |
| Expenses | |
| Operating and production | 427,607 |
| General and administrative | 227,307 |
| Interest | 78,434 |
| Depletion and amortization | 492,433 |
| | 1,225,781 |
| Income (loss) before income taxes | 316,712 |
| Deferred Income Taxes | 143,000 |
| Net Income | 173,712 |
| Earnings per Share | |
| Basic | 0.018 |
| Fully Diluted | 0.014 |

## 13. SUPPLEMENTAL PARTNERSHIP INFORMATION

Statement of Operations
For the period from inception, October 1, 1997, to December 31, 1997

| | $ |
|---|---|
| Revenue | |
| Petroleum and natural gas sales, net of royalties | 325,328 |
| Expenses | |
| Operating and production | 90,808 |
| Depletion and amortization | 136,159 |
| | 226,967 |
| Net Income for Period | 98,361 |

## CORPORATE INFORMATION

### HEAD OFFICE:

1480, 717 - 7 Avenue S.W.

Calgary, AB T2P 0Z3

### OFFICERS:

Michael J. Kryczka - President & Chief Executive Officer

Harry Issler - Vice President, Exploration

Kam A. Fard - Vice President, Production

Hugh M. Thomson - Vice President, Finance

Thomas W. Robinson - Secretary

### DIRECTORS:

Michael J. Kryczka - Chairman

Hugh M. Thomson - Chief Financial Officer

David M. Johnson
Director/Secretary - Pacific Ranger Petroleum Inc.

Robert W. Lamond
Chairman/President - Humboldt Capital Corp.

Charles A. Teare
Director/Chief Financial Officer - Humboldt Capital Corp.

Wayne M. Newhouse
President - Newhouse Resource Management Ltd.

### BANKING:

National Bank of Canada

### AUDITORS:

Stan Peloski, Chartered Accountant

### LEGAL COUNSEL:

Johnston Robinson Clark Anderson

### ENGINEERING:

Apex Energy Consultants Inc.

### COMMON SHARES LISTED:

Alberta Stock Exchange

Symbol: DPC

## NOTICE OF MEETING

The Annual General Meeting of the shareholders of Dundee Petroleum Corp. will be held on May 27, 1999, at 10:00 am at the Calgary Petroleum Club, Presidents Room (lower level), 319 - 5th Avenue, S.W., Calgary, Alberta.

Shareholders unable to attend are encouraged to complete and return the accompanying form of proxy.

## ABBREVIATIONS

| | |
|---|---|
| Bbls | Barrels |
| Bbls/day | Barrels of oil per day |
| MBbls | Thousand barrels |
| Bcf | Billion cubic feet |
| BOE | Barrels of oil equivalent (10 MCF equivalent to 1 Bbl) |
| MBOE | Thousands of barrels of oil equivalent |
| BOE/day | Barrels of oil equivalent per day |
| Mcf | Thousand cubic feet |
| Mmcf | Million cubic feet |
| Mcf/day | Thousand cubic feet per day |
| NGL | Natural gas liquids |

DUNDEE PETROLEUM CORP.

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